

YACHTING VAT NOTE

February 2008

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For Show and for Real

How to manage a yacht owner's anxiety about EU VAT?



This question commonly arises when the beneficial owner (Principal) of a commercial yacht wishes to use the yacht privately in the EU.

One way - part misconstrued experience and part industry folklore - is to go for show. This takes several forms. First is to draw up a charter contract for the use and get the Principal to pretend that he is an ordinary charterer with no connection to the legal yacht owner, usually a limited company. If challenged by the authorities he can show the contract. The contract would also serve to get tax-free fuel from suppliers to eligible yachts in commercial use.

If the Principal can temporarily deposit some funds in the company during the period he is using the yacht then that should assist the camouflage. In one variant of this show, the Principal is advised to use a separate company of his as the front charterer. The thin legal veneer often cited to justify these shows ranges from VAT passenger transport rules to French commercial exemption for yachts.

Second is to switch the registration status of the yacht itself from commercial to pleasure (or private). This seems to be the staple placebo for any Principal who is anxious about visiting Spain or other EU country that imposes VAT or other tax on yachts trading within its territorial waters. Switching to pleasure status is supposed to blindfold the authorities to any charter activity. Handily, some yachts do carry both pleasure and commercial certificates at the ready to switch and juggle.

And, third, what about trying some Temporary Importation (TI) relief as a way of carrying out charters or shielding that EU-resident Principal? After all, both the yacht and its legal corporate owner are non-EU. This notion glosses over the real fact: that TI authorisation forbids charters and also requires disclosure of the identity of the yacht users.

These shows are well-meaning, of course. But they are linked to the vexatious VAT schemes that the authorities condemn as artificial chartering to the private funder.

Really

The other way is real and different. It is based on a full and complete understanding of VAT law. It is founded on the legally tested ground that: a commercial yacht used both commercially and privately is recognised as a mixed use business asset within the VAT system; that connected

persons, whether the Principal, his family or his friends, are entitled by right and by law to the use of that commercial yacht if they so choose; and, logically, that if VAT was deducted on the yacht at the time of its purchase or import then there is an understandable VAT price to pay for that private or non-business use.

Finally, the real way concludes, in the spirit of the law, that the VAT price payable for such use is assessable by reference to the full cost of that use to the legal owner - the owning company - rather than to the market charter rate. This last under-stated fact does not allow the Principal a free ride over the EU VAT system. But it does give him real, legitimate relief. The ECJ decisions in *Kuhne* and in *Mohsche* put this point beyond doubt.

As to cruising to Spain or other EU country with local tax on the yachting trade, the matter is really no more complicated than ensuring that you do not operate there in sabotage fashion, with guests being picked up and dropped off, and charters beginning and ending, there.

So where does that leave the practice of vessel status switching within the EU? Well, exactly where it started: in the folkloric realm of show and tell.

Little wonder why most Principals readily understand and agree. After all, there will have been a substantial recovery of VAT on the yacht at the time of bringing it within the VAT system. Principals live in the real world and treasure their reputation and peace of mind. They know, even if instinctively, that VAT is as real as any other tax. They understand that, as with any other tax, it is the more fantastical shows that court adversity.

In that well-known parable of anxiety management, the hero - part savant, part blundering naïf - arrives at an important party with only one goal in mind: not to break the hostess's valuable Chinese vase. He wants to keep his distance, but ends up smashing it. It shows how trying too hard to avert a danger can instead make it happen.

What VAT Man did after...

This time last year UK tax authorities (HMRC) started their campaign against no-VAT schemes for private use of commercial yachts.

Our next Yachting VAT Note provides an update and examines HMRC's recommended approach for calculating the VAT charge on private use of business yachts.

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